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## **REPORT OF THE OFFICE OF INSPECTOR GENERAL ON INTERNAL CONTROL STRUCTURE**

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The Acting Secretary  
U.S. Department of Energy

We audited the consolidated financial statements of the U.S. Department of Energy (Department) for the year ended September 30, 1996, and have issued our report thereon dated December 27, 1996, except as to a portion of Note 16 which is as of January 31, 1997.

The management of the Department is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The internal control structure is to provide management with reasonable, but not absolute, assurance that the following objectives are met:

1. Transactions are executed in accordance with management's authorization and are properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with applicable accounting policies and to maintain accountability over assets.
2. Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.
3. Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements, and are in compliance with any other laws and regulations that the Office of Management and Budget (OMB), Departmental management, or the Inspector General have identified as being significant and for which compliance can be objectively measured and evaluated.
4. Data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Department of Energy for the year ended September 30, 1996, we considered its internal control structure in order to determine our audit procedures for the purpose of expressing an opinion on the financial statements. Our consideration included obtaining an understanding of the significant internal control structure policies and procedures, determining whether they had been placed in operation, assessing the level of control risk relevant to all significant account balances, and performing sufficient tests to assess whether internal controls are effective and working as designed. Our evaluation of the internal control structure was conducted to determine whether it met the objectives identified in the previous paragraph and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our evaluation of the controls for performance information was limited to those controls designed to ensure the existence and completeness of the information. With respect to the performance measure control objectives, we obtained an understanding of relevant control structure policies and procedures designed to permit the preparation of reliable and complete performance information and assessed control risk.

In evaluating the internal control structure, we considered matters reported by the Department in compliance with the Federal Managers' Financial Integrity Act, our prior and current audit reports, and other independent auditor reports on financial matters and internal accounting control policies and procedures. The Appendix to this report lists performance audit reports published by the Office of Inspector General during Fiscal Year 1996 that were considered in our evaluation of the internal control structure.

As part of our audit, we noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Department's ability to ensure that the objectives of the internal control structure, as previously defined, are being achieved. The conditions considered to be reportable conditions are discussed in the Exhibit to this report.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions or material weaknesses under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06. A material weaknesses is a condition in which

the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the consolidated financial statements being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we considered to be material weaknesses as defined above.

The audit also disclosed a number of other conditions relating to the Department's internal control structure that we did not consider to be reportable conditions and which did not materially affect the Department's financial statements. These matters will be communicated to management in 11 separate reports. Two reports will be issued to the Department's Chief Financial Officer and nine reports to field elements. The recommendations made in these reports are designed to strengthen internal controls or improve operating efficiencies.

*Office of Inspector General*  
December 27, 1996

## **Environmental Remediation Liabilities**

**Background:** The Department's estimate of environmental liabilities should reflect future costs associated with remediation of environmental contamination existing as of the last day of the fiscal year. At September 30, 1995, the Department's environmental liability was understated because it included only the estimated future costs of the environmental management program, which was derived from the Baseline Environmental Management Report (BEMR). The BEMR excluded estimates of remediation costs for active facilities (facilities with ongoing missions managed by other programs). To address this misstatement, the Office of Chief Financial Officer (CFO) developed an estimate of remediation costs for contaminated active facilities as of September 30, 1996. This estimate consisted of two principal components: (1) stabilization and deactivation costs based on cost models developed as part of the 1995 BEMR and (2) facility decontamination and decommissioning (D&D) costs based on D&D costs for similar facilities in the 1996 BEMR. The CFO also included costs for associated waste management and support.

To develop a reasonable estimate of remediation costs, the CFO needed accurate information on active facilities at 27 sites including the number of buildings or other structures, purpose or use, size, and the nature and extent of contamination. Data on facility size needed to be expressed in square feet for the CFO to use the BEMR models and estimation methods. The CFO relied on the Department's Facilities Information Management System (FIMS) to provide the basic data necessary to complete the estimate; however, FIMS did not report size information in square feet for some structures (e.g. pipes or electrical transformers). Therefore, the CFO required site personnel to provide additional information to supplement FIMS data for these types of structures. Also, to estimate the nature and extent to which active facilities were contaminated, the CFO made an initial assessment based on the facility use codes in FIMS. These initial assessments were then sent to site facility managers for review, feedback, and validation of the accuracy of the data.

### **Finding 1: Preparation of the Active Facilities Remediation Cost Estimate**

As a component of its overall internal control structure, the Department is responsible for establishing a system of controls to provide reasonable assurance that estimates supporting accruals of unfunded environmental liabilities are complete and readily verifiable. While the Department's first-year estimate of environmental remediation costs for active facilities was reasonable overall, it was not sufficiently documented at the site level to permit detailed audit verification of input data. Validation work performed by site facility managers was produced in a short period of time, was not based on formal studies, and did not use a standard set of assumptions for size data conversion. This occurred because the Department did not specify the type of information or extent of documentation

necessary to support site level validation work and did not provide facility managers with standard assumptions or rules for data conversion.

**Recommendation:** The Department should refine the process for estimating remediation costs for active facilities. Specifically, the CFO should develop and promulgate standard procedures for conversion of data to square feet and specify requirements for determining and documenting the extent and nature of contamination of active facilities. The CFO should also ensure that site level information supporting the estimate is sufficiently documented to allow audit verification.

**Management Reaction:** Management concurred with the recommendation and agreed to refine the process for estimating remediation costs for active facilities during Fiscal Year 1997. Specific instructions will be issued to field offices including requirements for retaining information to facilitate audit verification of all estimates.

**Auditor Response:** Management's planned actions are responsive to our recommendation.

### **Financial Management System**

**Background:** The Department's financial management system operates through a decentralized system composed of integrated contractors, field offices, power marketing administrations (PMAs), and Headquarters offices. Specific components of the system include (1) the Departmental Primary Accounting System, currently consisting of the Funds Distribution System, the Financial Information System, and the Departmental Integrated Standardized Core Accounting System (DISCAS); (2) the Payroll and Personnel System (PAY/PERS); (3) the Departmental Budget Formulation System; and (4) the PMAs' financial management systems. The financial management system was developed and implemented a number of years before the Department became subject to the requirement to produce consolidated financial statements.

In this regard, the PMAs present a unique challenge to the Department related to the preparation of consolidated financial statements. Unlike the rest of the Department, the PMAs do not directly integrate their financial accounting records into the Department's Primary Accounting System. They use a basis of accounting unique to the utility industry that is prescribed by the Federal Energy Regulatory Commission. Therefore, the PMAs must convert their accounting records to the U. S. Standard General Ledger (SGL) format

by means of a crosswalk when reporting yearend results to the Department. Complete PMA data is not included in the Department's financial management system at any other time throughout the year.

The Department is now involved in various efforts to develop and implement major enhancements to its financial management system. One series of enhancements, known as the Management Analysis Reporting System (MARS), was designed to update the system and to increase its usefulness. Phases I and II are complete, and Phase IIIA is currently underway. Phase IIIA includes a crosswalk of Departmental accounts to SGL accounts, which is the format required for U. S. Treasury reporting. Phase IIIB is to include implementation of SGL at the transaction level. The Department projects completion of these phases by September 30, 1998. The Department is also in the process of consolidating DISCAS operations at three financial service centers.

Our Fiscal Year 1995 report on the internal control structure contained a finding that the Department's financial management system was not directly capable of making financial statement-level adjusting, eliminating, and consolidating entries necessary to produce yearend financial statements. The Department took actions such as adapting the system to accept statement-level adjusting entries, requiring field offices to make needed adjusting entries when possible, and increasing review and approval requirements for statement-level adjusting entries to mitigate our previous concerns. However, as indicated by the following finding, further improvements in the Department's financial management system are needed to fully comply with Federal accounting and reporting requirements.

**Finding 2: Integration and Control of Financial Management Systems**

In accordance with OMB Circular No. A-127--Revised, each Federal agency is required to develop and maintain an integrated agency accounting and financial management system. Such systems must be capable of (1) collecting accurate, timely, complete, reliable, and consistent information; (2) maintaining consistent internal controls over data entry, transaction processing, and reporting; (3) supporting management information needs for budgeting, reporting, and decision-making; and (4) facilitating the preparation of financial statements and other financial reports in accordance with Federal accounting and reporting standards. Our Fiscal Year 1996 audit disclosed problems in the following areas:

- The processes used to convert data from the Departmental Primary Accounting System to external reporting formats were inconsistent with one another. Changes to the logic for crosswalking data to the SGL account structure did not keep pace with the changes made to the logic used for converting data to the OMB Bulletin No. 94-01 financial statement reporting format. In addition, changes in the logic for converting

data from the Department's account structure to the financial statement reporting format were not adequately documented.

- Information attributable to the PMAs was recorded in the Department's financial management system only through statement-level adjustments in an "off-line" system at yearend. The Department also had not developed and implemented a uniform process for converting PMA accounting data to the formats required for consolidated financial and Treasury reporting.
- The Department did not document a clear audit trail for certain yearend adjustments.
- Weaknesses existed in the general controls established for operation of the DISCAS. Specific weaknesses or inconsistencies involving separation of duties, software change controls, access controls, and contingency and disaster recovery planning were found at the three consolidated service centers that process DISCAS transactions.

These problems occurred because the Department's financial management system was not fully integrated, did not use the SGL at the transaction level, and did not ensure consistent implementation of internal controls throughout the system. As a result, the Department's financial management system did not fully reflect its consolidated position and results of operations and might have been susceptible to errors or problems due to general control weaknesses.

**Recommendations:** The Department should continue efforts toward financial information system integration through the following actions:

- Continue efforts to implement SGL at the transaction level.
- Ensure that when changes are made to the financial statement conversion process, they are also made to the SGL logic in a timely manner. Document, including rationale, all necessary changes to conversion logic for required external reporting.
- Develop a uniform process for converting PMA accounting information to the SGL format.
- Eliminate the need for ancillary "off-line" information systems and the manual yearend consolidation process by integrating the PMAs into the financial management system.

- Provide a fully documented audit trail for all yearend adjustments.
- Coordinate with each accounting site and consolidated service center to ensure consistent implementation of internal controls related to separation of duties, software change controls, and disaster recovery planning throughout the Department's financial management system.

**Management Response:** Management concurred with the recommendations. The CFO is developing and implementing major enhancements to the Department's financial management systems and processes. Specifically, implementation efforts are proceeding for Phase III of the MARS implementation schedule, which will include conversion for the Department's existing chart of accounts to the SGL accounts at the transaction level. Also, the CFO will continue to work with the PMAs to develop a uniform process for converting their yearend accounting information to the SGL format. The CFO will consider the potential for integrating the PMAs yearend SGL data into MARS to reduce the need for an off-line process for generating the Department's consolidated financial statements. In addition, the CFO will issue guidance to the consolidated service centers to address the general control deficiencies identified and will test and implement a disaster recovery plan in Fiscal Year 1997.

**Auditor Comments:** Management's planned actions are responsive to our recommendations.

### **Property, Plant and Equipment**

**Background:** The Department is charged with the responsibility of protecting and maintaining accountability over \$22 billion of Government property. Management of the vast majority of such property is delegated to the contractors that operate the Department's facilities across the country. These contractors are responsible for implementing financial and physical property accounting controls that are consistent with guidance promulgated by the Department and other cognizant Government bodies.

In our Fiscal Year 1995 report on the internal control structure, we reported that the Department's internal control system to prevent or detect the inconsistent or misapplication of accounting policies, principles, and procedures was not entirely effective. The Department has taken certain corrective actions; however, it still needs to strengthen its internal control system for property, plant and equipment.



**Finding 3: Remaining Property, Plant and Equipment Accounting Issues**

Departmental accounting directives specify property, plant and equipment accounting policies, principles, and procedures that are applicable to all Departmental elements. These directives and other policy guidance delineate the appropriate accounting treatment for a broad spectrum of events and transactions. During our Fiscal Year 1996 audit, we determined that the following problems existed:

- Some surplus, excess, or inactive facilities and equipment remained on the accounting records at cost less accumulated depreciation rather than being reduced to their net realizable value.
- Guidance on write down of book value of facilities used to treat, store, and dispose of legacy waste was not consistently applied.
- Some facilities and equipment used to treat, store, and dispose of legacy waste remained on the accounting records as assets rather than being expensed in the current period.
- Subsidiary ledgers were not always reconciled to control accounts.
- Construction and equipment work-in-progress projects were not always closed to completed property, plant and equipment in a timely manner.
- Some leases that met established capitalization criteria were treated as expense items rather than capitalized.

These problems occurred because contractors misinterpreted certain requirements and Heads of Field Elements did not ensure that contractors consistently applied applicable accounting criteria. Because of these problems, the Department's ability to ensure that its property, plant and equipment balance was properly stated was diminished.

**Recommendation:** The Department should clarify its guidance for writing down legacy waste facilities and instruct its field offices to ensure that valuation of respective property, plant and equipment is consistent with the guidance. No further recommendations are made because a number of audit findings were issued separately and will be addressed in management reports issued at the field element level.

**Management Response:** Management concurred with the recommendation and agreed to work closely with the Office of Inspector General and the field to determine the types of inconsistencies found at the sites and provide clarifying guidance as appropriate.

**Auditor Comments:** Management's planned actions are responsive to our recommendation.

**Office of Inspector General  
Fiscal Year 1996 Audit Reports**

<b><u>Report Number</u></b>	<b><u>Report Title</u></b>	<b><u>Date Report Issued</u></b>
IG-0380	Audit of the Department of Energy's Transportation Accident Resistant Container Program	October 11, 1995
IG-0381	Audit of Management and Operation Contractor Overtime Costs	October 27, 1995
IG-0382	Audit of the Department of Energy's Site Safeguards and Security Plans	December 1, 1995
IG-0385	Special Audit Report on the Department of Energy's Arms and Military-Type Equipment	February 1, 1996
IG-0387	Audit of Architect and Engineering Costs at the Idaho National Engineering Laboratory	March 22, 1996
IG-0388	Audit of Internal Controls Over Special Nuclear Materials	April 4, 1996
IG-0389	Summary Audit Report on Lessons Learned from the Superconducting Super Collider Project	April 23, 1996
IG-0390	Audit of Department of Energy Management and Operating Contractor Available Fees	May 8, 1996
IG-0391	Audit of Department of Energy's Activities Designed to Recover the Taxpayers' Investment in the Clean Coal Technology Program	June 6, 1996
IG-0392	Audit of the Department of Energy Program Offices' Use of Management and Operating Contractor Employees	July 8, 1996
IG-0394	Special Audit of Pension Plans for Department of Energy Contract Employees of the University of California	August 19, 1996
IG-0395	Audit of the Department of Energy's User Facilities	August 19, 1996

<b><u>Report Number</u></b>	<b><u>Report Title</u></b>	<b><u>Date Report Issued</u></b>
IG-0396	Audit of Department of Energy's Contractor Liability Insurance Costs	September 13, 1996
CR-B-96-01	Audit of the Federal Energy Regulatory Commission Leased Warehouse Space	May 24, 1996
ER-B-96-01	Audit of Work Force Restructuring at the Fernald Environmental Management Project	April 23, 1996
ER-B-96-02	Audit of Groundwater Remediation Plans at the Savannah River Site	June 11, 1996
WR-B-96-01	Audit of Fire and Emergency Medical Services Cost Sharing Between the Department of Energy and Los Alamos County	October 2, 1995
WR-B-96-02	Audit of Construction of an Environmental, Safety, and Health Analytical Laboratory at the Pantex Plant	October 6, 1995
WR-B-96-03	Audit of Construction Management at the Idaho National Engineering Laboratory	October 18, 1995
WR-B-96-04	Audit of Fuel Processing Restoration Property	October 20, 1995
WR-B-96-05	Audit of Consultant Agreements at Los Alamos National Laboratory	February 25, 1996
WR-B-96-06	Audit of Bonneville Power Administration's Management of Information Resources	April 2, 1996
WR-B-96-07	Subcontracting Practices at the Nevada Operations Office and Its Management and Operating Contractor	May 10, 1996
WR-B-96-08	Audit of the Management of the Cooperative Agreement with Texas to Fund the Amarillo National Resource Center for Plutonium	August 23, 1996